No. 94-560

In the Supreme Court of the United States

OCTOBER TERM, 1994

FIRST OPTIONS OF CHICAGO, INC.,
Petitioner,

v.

MANUEL KAPLAN, ET AL.,
Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENT CAROL KAPLAN

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QUESTIONS PRESENTED

1. Where the parties did not clearly and unmistakably agree that the question of arbitral jurisdiction was for the arbitrators and not for the courts, did the court of appeals properly review *de novo* the arbitrators' assertion of jurisdiction over the controversy?

2. Did the court of appeals properly apply ordinary appellate review to the district court's refusal to vacate the arbitration award, rather than altering the standard of appellate review based on the outcome of the district court proceedings?

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BRIEF FOR RESPONDENT CAROL KAPLAN

STATEMENT OF THE CASE

Respondent Carol Kaplan ("Mrs. Kaplan") adopts and incorporates by reference the Statement of the Case found in the Brief for Respondent Manuel Kaplan and supplements it as follows. Mrs. Kaplan is the wife of Respondent Manuel Kaplan ("Mr. Kaplan"). Mr. Kaplan has been the president, a director and sole shareholder of Respondent MK Investments, Inc. ("MKI"), formerly a stock options market maker on the Philadelphia Stock Exchange (the "Exchange"), since 1986. (Pet. App. at A-5.) Mrs. Kaplan has never had any ownership interest in MKI, nor has she ever been a member of the Exchange (J.A. 65).

The Work-Out Agreement

Shortly after the stock market crash of October 19, 1987, MKI entered into negotiations with its clearing firm, Petitioner First Options of Chicago, Inc. ("First Options"), toward the work-out of MKI's disputed debt to First Options arising out of trading losses sustained in the wake of the crash. First Options pressed Mr. Kaplan to assume personal liability for MKI's obligations. Mr. Kaplan refused. Instead, he and MKI disputed the size of MKI's deficit and claimed that First Options mishandled the liquidation of the MKI trading account. (Pet. App. at A-6.)

On March 24, 1988, MKI executed four documents comprising a work-out of the dispute that had resulted from MKI's trading losses. The four work-out documents were:

> 1) A "Letter Agreement" in which MKI acknowledged an indebtedness of $6,227,188 to First Options, to be repaid through certain specified initial prepayments and thereafter out of future MKI trading profits, and which contained releases from personal liability in favor of Mr. Kaplan and several other individuals (J.A. 4-23);
>
> 2) A "Subordinated Loan Agreement" in which the work-out was structured as a loan to MKI, subject to the repayment provisions of the Letter Agreement (J.A. 30-36);
>
> 3) A "Guaranty" by MKI of the debt of a related entity, Duck Brothers, to First Options (J.A. 24-29); and
>
> 4) A "Subordinated Promissory Note" of MKI to First Options in the principal sum of $6,227,188 (J.A. 37-38).

The Guaranty and Subordinated Promissory Note were signed by MKI only. (J.A. 29 & 38.) The Subordinated Loan Agreement was signed by First Options, MKI and Duck Brothers. (J.A. 36.) Only the Subordinated Loan Agreement contained an arbitration clause. (J.A. 34-35.)

The Letter Agreement provided for certain specified prepayments in addition to setting forth detailed terms for repayment out of MKI's future trading profits. For instance, Mr.

Kaplan agreed to make an immediate prepayment of $80,000 to First Options, and MKI agreed to immediately transfer four Exchange seats to First Options. (J.A. 6-7.) In addition, it was agreed:

> 4. *Tax Refunds.* Mr. Kaplan and Mrs. Carol Kaplan ("Mrs. Kaplan"), his wife, shall file (or cause to be filed) all necessary documents to obtain all tax refunds . . . which are now, or which may be or become, due or owing to Mr. Kaplan and/or Mrs. Kaplan from the United States Government or any state or local government. Mr. Kaplan and Mrs. Kaplan will file (or cause to be filed) 1987 federal and state tax returns by June 15, 1988 and promptly deliver copies thereof to you [First Options]. . . . Upon receipt of any and all tax refunds, Mr. Kaplan and Mrs. Kaplan agree to immediately remit the amount of such refunds to you which shall be applied by you to the prepayment of the Total Indebtedness. (J.A. 7.)

This obligation to apply for and remit tax refunds was Mrs. Kaplan's *only* obligation under the Letter Agreement. (Pet. App. at A-8.) She received *no consideration* in exchange for this undertaking. Mrs. Kaplan's rather tangential role in the work-out is further confirmed by the following language in the Letter Agreement which specifically limits the effect of her signature:

> Mrs. Kaplan is signing this agreement to evidence her agreement to sign all documents necessary to fulfill the terms of this agreement applicable to her. (J.A. 20.)

Thus, the sum total of Mrs. Kaplan's voluntarily assumed obligations was to sign tax documents necessary to obtain refunds, and to remit the amount of those refunds to First Options. This obligation appears in a document, the Letter Agreement, which contains no arbitration clause, and which specifically limits Mrs. Kaplan's obligation to the signing of documents necessary to implement "the terms *of this agreement* applicable to her." Nowhere in this Letter Agreement is

there the slightest suggestion that Mrs. Kaplan agreed to arbitrate any disputes that might arise with respect to "the terms of this agreement applicable to her" or that she agreed to be bound by *any* terms of the Subordinated Loan Agreement.

The Arbitration Proceeding

Despite the absence of any agreement to arbitrate in the Letter Agreement, on July 1, 1989, after a further dispute arose between First Options and MKI, First Options instituted a Philadelphia Stock Exchange arbitration proceeding which, *inter alia*, sought judgment against Mrs. Kaplan, as well as against Mr. Kaplan, for the amount of their 1987 tax refunds. Mrs. Kaplan refused to sign any submission agreement (J.A. 54) and filed an objection to arbitral jurisdiction at the outset (J.A. 54-55). She also filed an answer which emphasized her marginal role in the work-out and the gratuitous nature of the obligation she undertook:

> [Mrs.] Kaplan admits that she signed the agreement referred to as the March 24, 1988 Agreement (the "Agreement") for the sole and limited purposes of Paragraph 4 relating to the Manuel Kaplan and Carol Kaplan 1987 income tax refund requests, and no other purpose. Her execution of the Agreement for that purpose was strictly as an accommodation. (R. 167)

On February 26, 1990, the attorney then representing both Mr. and Mrs. Kaplan in the arbitration proceeding participated in a discovery conference, having withdrawn the Kaplans' jurisdictional objections "from consideration *at the February 26, 1990 discovery conference*." (J.A. 55, emphasis added.) The discovery order which resulted from that conference made no mention of the jurisdictional issue. (*Id.*) From February 26, 1990 until December 1991, the arbitration proceeding was essentially dormant. (*Id.*)

On January 6, 1992, the Kaplans filed a motion and supporting memorandum seeking the dismissal of the claims against them for lack of jurisdiction. (*Id.*) On January 14, 1992, without waiting for a brief in opposition, the arbitration panel issued an

order stating simply that "[i]t is hereby determined and decided, *after full consideration*, that . . . Respondents' Motion to Dismiss for Lack of Jurisdiction, dated January 6, 1992, is hereby denied . . . ." (J.A. 39, emphasis added.) The arbitrators' decision, issued June 5, 1992, awarded First Options $346,342 (the amount of the Kaplans' 1987 joint federal tax refund) against Mr. and Mrs. Kaplan jointly and severally, with interest from January 17, 1989.[1]

The District Court's Ruling

On cross-petitions to vacate and confirm the arbitration award, the district court upheld the arbitrators' assertion of jurisdiction over Mr. and Mrs. Kaplan despite the fact that they were not parties to the Subordinated Loan Agreement:

> The Letter Agreement and the Subordinated Loan Agreement were executed in tandem, are inextricably intertwined and mutually dependent and must be read as a whole, particularly given the underlying circumstances and relationships of the parties. In view of this and the well-established federal policy favoring arbitration, the court concludes that pursuant to the arbitration provision in the subordinated loan document, the arbitration panel had jurisdiction over the Kaplans. (Pet. App. at C-14 - 15, citation omitted.)

The district court did not specify which "underlying circumstances and relationships" relevant to Mrs. Kaplan informed its application of the Subordinated Loan Agreement's arbitration provision to her, nor did the district court (which purported to carefully parse the various agreements, Pet. App. at C-13) address the provision which specifically limited the effect of Mrs. Kaplan's signature on the Letter Agreement to evidencing "her agreement to sign all documents necessary to fulfill

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1. The arbitrators also awarded First Options $5,662,188 against MKI and Mr. Kaplan jointly and severally, with interest from January 17, 1989. (J.A. 41-42.) Mr. Kaplan filed a voluntary petition for relief under the Bankruptcy Code on February 2, 1993.

the terms *of this agreement* applicable to her." Indeed, the district court appeared to perceive no distinction whatever between the rights and obligations of Mrs. Kaplan under the Letter Agreement, to the extent there were any, and those of any other party. (Pet. App. at C-11).

The district court also upheld arbitral jurisdiction on the alternative ground that the Kaplans had waived their jurisdictional objection by participating in the February 26, 1990 discovery conference and not thereafter reasserting the jurisdictional objection until January 1992. (Pet. App. at C-17 - 18.) The district court confirmed the arbitration award and entered judgment thereon. (Pet. App. at C-34 - 35.)

The Court of Appeals' Ruling

Exercising *de novo* review of the jurisdictional issue, the court of appeals observed that of the various bases for arbitral jurisdiction asserted by First Options, only the arbitration clause in the Subordinated Loan Agreement could potentially apply to Mrs. Kaplan. (Pet. App. at A-32, n.17.) The court of appeals found this argument unavailing as to either of the Kaplans:

> The circumstances of this case plainly negate the Kaplans' consent to arbitrate their individual responsibility for MKI's obligations. In the document they signed, they undertook only limited and precisely defined obligations. . . . They did not sign any documents that stated they would arbitrate their individual liability under the workout. (Pet. App. at A-26.)

The court of appeals also rejected the district court's holding that the Kaplans had waived their objections to arbitral jurisdiction:

> The Kaplans refused to sign any submission form. They asserted their objection to jurisdiction at the beginning of the arbitration proceedings. They reasserted it on the record before the arbitrators. Even if their former counsel withdrew the objections from

> consideration in order to participate in the discovery conference, neither that withdrawal or its scope is docketed or expressly noted in the arbitration record. Later, the Kaplans reasserted their objection in a motion to dismiss for lack of jurisdiction they filed in 1992, when the arbitration proceeding resumed. During the two years between the 1990 discovery conference and the Kaplans' reasserting of their objection, the case was dormant, without discovery, hearing, motion or ruling. (Pet. App. at A-18.)

Accordingly, the court of appeals reversed the order of the district court and remanded with instructions to enter in its place an order vacating the arbitrators' award against the Kaplans. First Options petitioned for certiorari on September 27, 1994. On September 29, 1994, while the petition for certiorari was pending, First Options commenced a separate action against Mrs. Kaplan in the district court, again seeking judgment in the amount of $346,342 on the basis of Paragraph 4 of the Letter Agreement (E.D. Pa. No. 94-5941). That case has been stayed pending the ruling of this Court, which granted certiorari on December 5, 1994.

SUMMARY OF ARGUMENT

Mrs. Kaplan adopts and incorporates by reference the arguments set forth in the Brief of Respondent Manuel Kaplan with respect to the issues on which certiorari was granted. Regardless of how that Court decides those issues, it may affirm the judgment of the court of appeals with respect to Mrs. Kaplan on the additional ground that even under a highly deferential standard of review, the arbitrators' assertion of jurisdiction over Mrs. Kaplan on the basis of an arbitration clause in an agreement to which she was not a party demonstrated an infidelity to their duty to construe and apply the agreements from which their powers purportedly derived, agreements which specifically negated any consent to arbitration by Mrs. Kaplan.

ARGUMENT

EVEN UNDER A DEFERENTIAL STANDARD OF REVIEW, THE ARBITRATORS' ASSERTION OF JURISDICTION OVER MRS. KAPLAN COULD NOT BE SUSTAINED.

Mrs. Kaplan adopts and incorporates by reference the arguments set forth in the Brief of Respondent Manuel Kaplan with respect to the degree of deference to be accorded to the arbitrators' jurisdictional determination and the appropriate standard of review to be applied by the court of appeals. Mrs. Kaplan did not "clearly and unmistakably" agree to be bound by the arbitrators' determination of their own jurisdiction. Moreover, the federal policies favoring enforcement of private arbitration agreements, efficient resolution of disputes, and judicial economy all support a rule that allows a party to argue jurisdictional objections to an arbitrator without waiving her rights to *de novo* judicial review of arbitrability. The rule urged by First Options, requiring immediate resort to the courts, will cause the judiciary to become mired in far more disputes over arbitrability than would be necessary if arbitration were allowed to take its course. And First Options' suggested "hybrid" standard or review — requiring courts of appeals to review district court confirmations of arbitration awards with greater deference than vacaturs — should be rejected as an unprincipled attempt to alter the institutional role of the courts of appeals to favor certain substantive outcomes. For these reasons, the court of appeals' judgment in Mrs. Kaplan's favor should be affirmed.

This Court, of course, may also affirm the judgment of the court of appeals "on any ground that the law and the record will permit and that will not expand the relief granted below." *Thigpen v. Roberts*, 468 U.S. 27, 29-30 (1984); *United States v. New York Telephone Co.*, 434 U.S. 159, 166 n.8 (1977). Regardless of how this Court rules with respect to the issues on which certiorari was granted, the judgment of the court of appeals in favor of Mrs. Kaplan should be affirmed because the arbitrators' assertion of jurisdiction over her cannot be sustained under *any* standard of review.

As Petitioner correctly points out, Pet. Br. at 21-22, this Court and others have variously formulated the special degree of deference to be accorded to certain arbitral decisions. An arbitral decision entitled to judicial deference cannot be overturned unless in "manifest disregard" of the law[2] or "not in any rational way . . . derived from the agreement."[3] It should be sustained "as long as the arbitrator is even arguably construing or applying the contract,"[4] or as long as it "draws its essence" from the contract.[5] Even under these rather undemanding standards, the court of appeals would rightly have vacated the arbitral award against Mrs. Kaplan because there simply was no basis for concluding that she consented to arbitrate *anything*.

It is a bedrock proposition that arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which she has not agreed to submit. *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. 643, 648 (1986). Although federal policy favors expansive coverage when the subject matter scope of an acknowledged arbitration agreement is in question, *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24-25 (1983), no such presumption in favor of arbitration applies to the question whether a party has entered into an agreement to arbitrate in the first place. *See Case International Co. v. T.L. James and Co.*, 907 F.2d 65, 67 (8th Cir. 1990); *McCarthy v. Azure*, 22 F.3d 351, 355 (1st Cir. 1994) ("The federal policy [favoring arbitration] presumes proof of a pre-existing agreement to arbitrate disputes arising between the protagonists. . . . [It] does not extend to situations in which the identity of the parties who have agreed to arbitrate is unclear.").

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2. *Wilko v. Swan*, 346 U.S. 427, 436 (1953).

3. *Ludwig Honold Manufacturing Co. v. Fletcher*, 405 F.2d 1123, 1128 (3d Cir. 1969).

4. *United Paperworkers International Union v. Misco, Inc.*, 484 U.S. 29, 38 (1987).

5. *United Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 596 (1960).

The existence *vel non* of an agreement binding a party to arbitrate, as opposed to its scope, must be determined by ordinary contract principles without reference to any policy favoring arbitration, as it is the judicial enforcement of extant agreements to arbitrate, not the creation of arbitration agreements as such, that the Federal Arbitration Act seeks to promote. *See Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987).[6] Because consent to arbitrate implies that the parties "consciously trade[d] the safeguards of full-fledged adjudication in the courts for the greater speed and lower costs of alternative dispute resolution," *National Wrecking Co. v. Teamsters Local No. 731*, 790 F. Supp. 785, 790 (N.D. Ill. 1992), consent to arbitration must be shown by a clear and specific agreement. *Case International Co.*, 907 F.2d at 67; *Par-Knit Mills, Inc. v. Stockbridge Fabrics Co.*, 636 F.2d 51, 54 (3d Cir. 1980).

Here the only evidence proffered that Mrs. Kaplan consented to arbitrate *any* dispute with First Options is the arbitration clause contained in the Subordinated Loan Agreement, to which Mrs. Kaplan was not a party. The arbitrators' summary denial of Mrs. Kaplan's jurisdictional objection (J.A. 39) gives no indication of how the arbitrators inferred her consent to arbitrate from this.[7] The district court's attempt to show that

6. Thus, the district court's reliance on "the well-established federal policy favoring arbitration," Pet. App. at C-13, as a factor in finding that Mrs. Kaplan had consented to arbitration, was misguided. The district court's confusion is further highlighted by its reliance on *Com-Tech Associates v. Computer Associates Int'l, Inc.*, 753 F. Supp. 1078 (E.D.N.Y. 1990), *aff'd on other grounds*, 938 F.2d 1574 (2d Cir. 1991). In that case there was no issue of enforcing an arbitration agreement against a non-party to the agreement. Rather, the only issue was the scope of the agreement, where it was undisputed that the parties had agreed to arbitrate.

7. It is clear, however, that the arbitrators did not deem the objection waived. Their decision stated that the objection was given "full consideration." Thus, the district court's alternative ground for affirming the assertion of jurisdiction over Mrs. Kaplan, waiver, flies in the face of the arbitrators' own actions. (In addition, in finding waiver, the district court found it "compelling" that Mr. Kaplan had filed a counterclaim. Pet. App. at C-17. Even if that had constituted a waiver by Mr. Kaplan, a view the court of appeals correctly rejected, it surely was not a waiver by Mrs. Kaplan.)

the arbitrators' decision could "rationally be derived" from the contract (Pet. App. at C-10), however, demonstrates just the opposite.

To hold Mrs. Kaplan to the arbitration clause in the Subordinated Loan Agreement, the district court relied, vaguely, on the "underlying circumstances and relationships of the parties." (Pet. App. at C-13.) Mrs. Kaplan's *only* relationship to any party to the Subordinated Loan Agreement was her status as the spouse of the principal of a corporate party, MKI. Needless to say, no rule of contract law, family law, corporation law or agency would permit a corporation to bind the wife of a stockholder to arbitration.

The other factor seemingly relied upon by the district court in its attempt to rationalize the assertion of jurisdiction over Mrs. Kaplan was her status as a signatory to the Letter Agreement, which was executed the same day as the Subordinated Loan Agreement and which cross-referenced it. The district court found the two agreements "inextricably intertwined and mutually dependent." Pet. App. at C-13. This observation can hardly be characterized as contractual construction, since it gives utterly no effect to the basic fact that separate agreements were signed — and instead effectively treats them as a single agreement — and it completely disregards the very limited and gratuitous nature of the obligation undertaken by Mrs. Kaplan in the Letter Agreement, *i.e.*, applying for and remitting tax refunds. Moreover, it gives no effect whatever to the plain language of the Letter Agreement which explicitly limited the effect of Mrs. Kaplan's signature to obligations found within the four corners of the Letter Agreement:

> Mrs. Kaplan is signing this agreement to evidence her agreement to sign all documents necessary to fulfill the terms *of this agreement* applicable to her. (J.A. 20, emphasis added.)

Thus, Mrs. Kaplan specifically negated any implication that she was consenting to *anything* other than her obligations under Paragraph 4 of the Letter Agreement, much less consent-

ing to forego her right to assert any defenses she might have — such as lack of consideration or duress — in a judicial forum. The assertion of arbitral jurisdiction over Mrs. Kaplan was not simply a "misinterpretation" of the Letter Agreement or the Subordinated Loan Agreement, it was a complete abdication of the arbitrators' obligation to construe the contracts at issue, rather than simply to dispense their own brand of justice.

As the court of appeals correctly observed:

> The circumstances of this case *plainly negate* the Kaplans' consent to arbitrate their individual responsibility for MKI's obligations. . . . There is *no ambiguity* about the absence of any consent to arbitrate in the documents the Kaplans signed individually. (Pet. App. at A-26 - 27, emphasis added.)

This finding justified vacatur of the award against Mrs. Kaplan under even the most deferential standard of review. Although the FAA insulates certain arbitral findings from searching judicial review to avoid "judicializing" the arbitration process, it does not absolve arbitrators of the duty to ground their actions in the words of the agreements from which they purportedly draw their powers. An arbitral award should be vacated "where an arbitrator 'manifest[s] and infidelity' to her obligation to interpret the contract, [or] ignores a plain and unambiguous provision of the contract." *Apex Fountain Sales, Inc. v. Kleinfeld*, 818 F.2d 1089, 1094 (3d Cir. 1987) (citations omitted).[8] Here the arbitrators failed to heed this obligation when they asserted jurisdiction over Mrs. Kaplan.

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8. *See also Georgia-Pacific Corp. v. Local 27, United Paperworkers Int'l Union*, 864 F.2d 940, 944 (1st Cir. 1988); *Leed Architectural Products, Inc. v. United Steelworkers, Local 6674*, 916 F.2d 63, 65 (2d Cir. 1990); *AP Parts Co. v UAW*, 923 F.2d 488, 491-92 (6th Cir. 1991); *Tootsie Roll Indus., Inc. v. Local Union 1, Bakery, Confectionery & Tobacco Workers Int'l Union*, 832 F.2d 81, 84 (7th Cir. 1987); *Inter-City Gas Corp. v. Boise Cascade Corp.*, 845 F.2d 184, 187 (8th Cir. 1988).

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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